

IFN SAUDI

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IFN SAUDI ONAIR REPORT

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DISCUSSION INTRODUCTION

BACK-TO-BASICS: OPPORTUNITIES FOR ISLAMIC FINANCE TO FLOURISH IN SAUDI ARABIA

The world has changed. How our industry - Islamic banking, finance and investment - chooses to respond to these changes may be a generation-defining moment. How can Islamic finance mobilize in Saudi Arabia to address the imminent challenges of the real economy and provide not just liquidity support, but solvency support to the Saudi SME and corporate sector? Can Islamic finance in the Kingdom use this opportunity to become truly responsible, inclusive and ethical, while at the same time contributing to the country's growth and development? How can we as an industry ensure this is substance over form on a permanent basis? How can the core values of Islamic finance be further applied to sustainable and socially responsible finance and investment strategies and how can the UN Sustainable Development Goals be applied to the Kingdom's Islamic finance activities? How can Islamic finance continue to play a role in the progress and development in Saudi Arabia's important housing, mortgage finance and privatization programs? We ask a respected panel for a new roadmap to success for Islamic banking, finance and capital markets in Saudi Arabia.

YOUR PANEL



ABDULKADER THOMAS
Group CEO, SHAPE™
Knowledge Services



ASAD AHMED
Managing Director, Alvarez & Marsal



PAUL LATTO
Partner, DLA Piper seconded to
Alshahrani Almansour



DR SUTAN EMIR HIDAYAT
Director of Islamic Economy Supporting
Ecosystem, National Committee of
Islamic Finance



SAUDI STRENGTH: SETTING UP FOR A BIG YEAR AHEAD

IFN Saudi Arabia Forum is always one of the highlights of the REDmoney events calendar and, despite being in a slightly different format, 2020 was certainly no exception. IFN brought together some of the most influential and experienced experts in the GCC region to discuss the most pressing issues facing the Kingdom today — and how it can continue to forge a role for itself as one of the biggest and most influential Islamic finance markets in the world. LAUREN MCAUGHTRY writes.

One of the largest and most influential Islamic finance markets in the world and accounting for an estimated 20% of total Islamic assets in the GCC, Saudi has seen a spate of mergers and acquisitions in 2020 to consolidate its banking market into an even stronger segment. Its Islamic fund industry is the biggest in the world and home to a thriving REIT sector, while its debt capital market continues to grow from strength to strength both domestically and internationally, including the launch last year of the Kingdom's first-ever green Sukuk.

So where should Saudi go from here — and what are its priorities as we near the end of the challenging year that has

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- Dr Fahad Abdullah Aldossari



been 2020, and look with hope toward a brighter (and less COVID-19-filled) 2021?

SAMA speaks

We were delighted to welcome Dr Fahad Abdullah Aldossari, the deputy governor of apex regulator the Saudi Arabian Monetary Authority (SAMA), who gave us his optimistic insights into the future of the Saudi market.

"The Islamic financial services industry in Saudi Arabia has shown resilience during the peak of the COVID-19 outbreak," Dr Fahad emphasized. "Islamic banking assets increased at an annual growth rate of 16% in the first half of 2020, standing

at SAR1.8 trillion (US\$480.6 billion) at the end of June 2020. Islamic banking assets in Saudi Arabia represent almost 25% of global Islamic banking assets, and 72% of the total banking assets at the national level, as of Q2 2020. In addition, the Islamic capital market recorded a significant surge in the issuance of Sukuk, led by sovereign issues by the Ministry of Finance with maturities of up to 30 years. In fact, just in the first half of this year, the Ministry of Finance issued Sukuk worth SAR97 billion (US\$25.8 billion).

"On the corporate Sukuk side, we have observed constant growth over the past three years in local and international Sukuk issued by different sectors of the economy. During the first half of 2020, there have been SAR3.7 billion (US\$987.8 million) of Saudi Sukuk issued locally and US\$1.9 billion of US dollar Sukuk issued by Saudi companies in international markets.

"The nature of Islamic finance is founded on the linkage of the financial system with the real economy. This linkage enables Islamic financial institutions to withstand shocks to the financial system. In addition, a rich variety of Islamic financial products have been introduced, which has created a favorable diversification effect that contributed to increased demand, as well as an enhancement of profitability and stability. Islamic financial institutions have repeatedly therefore been able to navigate challenging circumstances without incurring heavy losses.

"Here at SAMA, we believe the industry can be developed further by tackling a number of challenges. These areas of improvement which SAMA is working on can be summarized into four main categories. The first: operational and human capacity-building, to lead increased efficiency. Second, Shariah governance to increase confidence in products and services. Third, to improve awareness and increase financial literacy. And lastly, promoting innovative technologies to improve efficiency and inclusion."

SAMA has undertaken a number of admirable policy actions to contribute to developing the industry both qualitatively and quantitatively, with a particular focus on innovative fintech solutions. It recently established a sandbox to enable fintech technologies to be tested in a safe environment, and in 2018 partnered with the Capital Market Authority to launch Fintech Saudi to develop the industry further and enable access to

opportunities for all. The global pandemic exposed financial systems around the world to unexpected pressure. Central banks have reacted in a timely manner and added a diversified set of monetary, supervisory and regulatory actions. SAMA is no exception, and early on introduced a comprehensive private sector financial support package directed at SMEs, as well as injecting SAR50 billion (US\$13.3 billion) into the banking sector to ensure it can continue providing credit.

"Financial inclusion is a continuously moving target, not a static issue"

- Asad Ahmed



Back to basics

Moving on from the regulatory perspective, the first session of the day zeroed in on the question of progress: exploring how Islamic finance can help Saudi Arabia to address the imminent challenges of the real economy and provide not just liquidity support, but solvency support to the Saudi SME and corporate sectors. The conversation also addressed the issues of inclusivity and ethics, discussing the tricky issues of substance over form and exploring how the core values of Islamic finance can be applied to sustainable and socially responsible financial goals, as well as playing a pivotal role in the vital sectors of housing, mortgage finance and privatization as Saudi seeks to diversify away from oil through its Vision 2030.

Able hosted by Abdulkader Thomas, group CEO of SHAPE Knowledge Services, the panel comprised both local and international experts across a wide range of fields.

Paul Latto, a partner at DLA Piper, seconded to Alshahrani Almansour, highlighted the emerging confluence between environmental, social and governance and Shariah compliance, as well as emphasizing the fintech element and especially the Saudi regulatory sandbox, which he called "critical and very interesting", while he also stressed the

level of regulatory change we have seen recently in Saudi Arabia. "That's going to help on a broad basis, across a lot of areas," he noted.

Financial inclusion was one of the most thoroughly discussed topics and Asad Ahmed, the managing director at Alvarez & Marsal, was optimistic. "Financial inclusion is a continuously moving target, not a static issue," he stressed. "There is no such thing as a late start."

Dr Sutan Emir Hidayat, the director of the Islamic Economy Supporting Ecosystem at Indonesia's National Committee for Islamic Economy and Finance, agreed emphatically. "There is a strong link between financial literacy and financial inclusion," Dr Sutan pointed out. "By enhancing one, you enhance the other. But how can you ensure SMEs in Saudi Arabia can access the Islamic financial services they need? As they grow and look for financial opportunities, Islamic institutions should be looking to provide that for them."

"There is a strong link between financial literacy and financial inclusion. By enhancing one, you enhance the other"

- Dr Sutan Emir Hidayat



The role of fintech was another hot topic during the session, and Asad noted that: "The mobile phone itself is creating a whole new stream of financial inclusion."

The conversation also revolved around the type of customer in Saudi Arabia, and what they were really looking for when it came to Islamic products. "I am coming more and more to the conclusion that there is room and appetite for a true risk-sharing model when it comes to SMEs," suggested Asad. "I have looked at portfolios of banks and their SME lending capacity, and empirically, you find that if there was a risk-sharing element based on profitability for SMEs, they would come out ok. I think there is an opportunity here for some work to be done — it could be a fundamentally different way for banks to look at Islamic finance, but I think it is an achievable way." 📌

FUNDING, INFRASTRUCTURE, CAPITAL MARKETS AND RESPONSIBLE FINANCE INITIATIVES IN SAUDI ARABIA

With the Kingdom issuing its first green Sukuk, how can sustainable and responsible finance make further progress in Saudi Arabia and can the UN Sustainable Development Goals be applied to the Kingdom's Islamic finance and investment activities? Are social bonds an opportunity for the Kingdom? Are regulatory Sukuk still a viable option for Saudi Arabian banks seeking to enhance liquidity and capital management, while diversifying funding sources? Where is the Saudi Arabian asset management industry heading and how has the progress been for recent product innovations, particularly Real Estate Investment Trusts and Sukuk Funds? What is the potential of Waqf for capital markets in Saudi Arabia? How is Waqf typically structured and what are the main variations? Lastly, we examine the Kingdom's infrastructure requirements in the coming years and ask what can be funded through Islamic facilities, how can risk be effectively managed and do public/private partnerships offer a viable opportunity?

YOUR PANEL



DR JOHN SANDWICK
General Manager, Safa Investment Services



ASHRAF MADANI
Vice-President, Moody's Investors Service



LAWRENCE OLIVER
Deputy CEO, DDCAP Group



NICOLAS BREMER
Partner, Alexander and Partner



PAUL MCVIETY
Head of Islamic Finance, DLA Piper



ZAINEB SEFIANI
Founder and Director, Carrera Learning

FUNDING THE FUTURE

Day 2 welcomed detailed discussions around the future of Saudi Arabia's own capital markets, exploring the funding, infrastructure and responsible finance requirements within the Kingdom and looking at how the asset management industry and both the equity and debt capital markets are evolving to meet the ever-changing needs of this vast market.

Host Dr John Sandwick, the general manager at Safa Investment Services, was joined by a diverse panel of experts including lawyers, service providers and fintech pioneers for a lively discussion around progress and innovation within the Kingdom's financing structures.

"It's fair to say that these days, rather than just seeing the odd deal with Shariah compliant funding involved, almost all deals within the project and infrastructure space in Saudi Arabia now have a significant component of Shariah compliant funding to them"

- Paul McViety



Paul McViety, the head of Islamic finance at DLA Piper, pointed out the steady growth he's seen in Islamic finance in Saudi Arabia since 2004, especially in the realm of project finance. "It's fair to say that these days, rather than just seeing the odd deal with Shariah compliant funding involved, almost all deals within the project and infrastructure space in Saudi Arabia now have a significant component of Shariah compliant funding to them. The structures have evolved, we see a wide variety of different Islamic banks with appetite for investing in those kind of projects, and that has been supported more recently by an acceleration of legal and regulatory change within the Kingdom over the past three to five years, culminating recently with some really significant developments that have opened up the capital markets, and made banking and financial transactions more generally feasible and de-risked within the Kingdom. Going forward, the focus should be on promoting more direct foreign investment within the Kingdom itself."

Nicolas Bremer, a partner at Alexander and Partner, agreed. "We have certainly seen a significant regulatory development that allows us to structure transactions according to international best standards. But maybe the more relevant development that we have seen in Saudi, that I have seen lacking in other countries in the region, is the development of the regulators themselves, the authorities that we work with. You can have very effective legislation but if you don't have regulators that will work with you, you will always run into trouble somewhere. It really comes down to the staff that you are working with, and we are really seeing a generational shift at these regulators where we see a lot of young, highly trained professionals with a different mentality — more deal focus, more customer focus, a better understanding of the time pressures that a Sukuk issuer, for example, might face."

Ashraf Madani, a vice-president at Moody's Investors Service, noted that over the past three years he has seen significant development on the capital markets front in Saudi. "This development has been based on the joint effort between the Ministry of Finance, SAMA and the Capital Market Authority," he said. "We have seen the Ministry of Finance establishing a dedicated Debt Management Office responsible for attracting international capital to meet funding requirements. This office is excellent, with sophisticated programs in place and a strong investor base. The sophistication and the transparency have improved immeasurably."

Lawrence Oliver, deputy CEO of leading intermediary DDCAP Group, talked about how the Saudi Arabian marketplace is evolving, and in particular the significantly increasing volumes they are seeing within the Kingdom and the role that technology is playing in promoting that. "What is driving the growth of Islamic finance in Saudi Arabia? We are seeing extremely high requirements for Shariah funding in the Kingdom. The new advanced efficiencies provided by the banks and intermediaries are helping to provide an increasingly efficient service. Banks are coming to us looking for streamlined processes and enhanced technological functionality. It's difficult to underestimate the significance of the role that technology now plays."

To learn more about the growth and development of Islamic finance in Saudi Arabia, and to hear the detailed, insightful and exclusive discussions held by our expert panelists (only a tiny portion of which we have been able to convey within these pages), check out the full recording for free at www.redmoneyevents.com. ☺

"Essentially we are talking about reconnecting Saudi Arabia's economy to the global economy through the capital markets, and some of the most innovative ways that this region has started to reach out to global capital in terms of bringing in the necessary capital for the very aggressive and much-needed economy growth that they desire," explained Sandwick.

The conversation ranged from regulatory Sukuk to responsible finance, asset management, Waqf, infrastructure financing and public-private partnership, with energetic debates over numerous granular elements detailing the nitty-gritty of what needs to be done to promote progress.